HURRICANE HYDROCARBONS LTD.

Annual Report

1998

December 31st

#2700, 300 – Fifth Avenue S.W. Calgary, Alberta, Canada T2P 3C4 Tel: (403) 221–8435 Fax: (403) 221-8425

1998 Annual Report

Message to Shareholders

1998 started out well for Hurricane. Both production and prices showed increases during the first quarter of 1998. The environment changed significantly in the second half of 1998 and proved to be very challenging. Internal oil markets in Kazakhstan were dramatically impacted by both the world oil price collapse and severe contractions in the Russian and Kazakh economies. The Russian currency devaluation in relation to the US dollar, coupled with high oil inventories and low oil prices in Europe, resulted in the entry of large volumes of Russian crude and refined products into Kazakhstan. This completely saturated Kazakh markets and severely depressed prices. As a result, Hurricane saw dramatic drops in its oil and refined product prices in the last half of the year. This drop in prices, coupled with high pipeline tariffs from the Kumkol field to Shymkent refinery, a $20 per tonne Shymkent refining toll charge and a dramatic drop in Shymkent's refinery gate oil purchase quotes, had a significant negative impact on Hurricane's cash flow for 1998. To address this situation, Hurricane curtailed capital expenditures during the third quarter of 1998, reduced its expatriate staff by 40%, and moved rapidly to identify significant cost reductions programs and initiatives for 1999.

Average daily production in 1998 for Hurricane Kumkol Munai was 52,967 barrels of oil per day ("bopd"), an increase of 16% from 1997. Average daily production for the year peaked during December at 61,220 bopd. Production was curtailed in October and November as a result of a scheduled maintenance shutdown at the Shymkent refinery from October 15 to November 11 and due to a dispute with the refinery over toll processing volumes and charges. In spite of this, overall average daily production for the year increased approximately 7,400 bopd from the 1997 average production of 45,603 bopd. In total, Hurricane produced approximately 19.3 million barrels of crude oil during 1998 compared to 16.6 million barrels in 1997.

Hurricane drilled 20 successful wells in South Kumkol and Kumkol South. Hurricane also contract drilled two wells for a third party. Seven successful wells were drilled by the Joint Vent in Kumkol North. Hurricane owns a 100% interest in a 455,672 acre exploration license surrounding the Kumkol field. The license was issued in June 1997 and is in effect for five years. Hurricane's 1998 exploration program was completed during the third quarter with the drilling of 3 unsuccessful wells and the gathering of 290 miles of seismic data. The information collected, along with previously gathered data, will be interpreted before any new exploration wells are drilled.

Hurricane plans to continuously examine opportunities to reduce costs. Hurricane has now refined its cost control systems, and has eliminated all discretionary capital expenditures with the exception of approximately $1.5 million for upgrading the central processing facility and completing group station 2 in South Kumkol.

Hurricane experienced a dramatic drop in oil prices during the last half of 1998 from a high (including value added tax ("VAT")) of $ 86.25 per tonne ($ 11.13 per barrel) to a low of $ 45.60 per tonne ($ 5.89 per barrel) at the end of the year. Hurricane sold substantially all of its production as refined products in the first quarter of 1998. During the second and third quarters Hurricane principally sold its production as crude directly to the Shymkent refinery. The relationship between Hurricane and the refinery deteriorated in the third quarter primarily over the issue of toll processing volumes and charges; however, the two parties did reach an agreement in November which allowed Hurricane to refine its crude at a toll processing fee of $ 20 per tonne and sell the refined products directly to its own customers.

Hurricane continued to examine the feasibility of export market opportunities throughout 1998, but because of low world oil prices, export markets were not considered economic.

During 1998 Hurricane developed plans for the Gas Utilization Project which remains a component of Hurricane's strategy to optimize the use of associated gas derived from its oil field production operations at Kumkol. A Protocol of Intent was prepared that committed all stakeholders to supporting the project. The protocol was signed by Hurricane Kumkol Munai, Kumkol LUKoil JV, and the Kazgermunai Joint Enterprise along with the regional governments of the Kyzylorda and Karaganda Oblasts and the central ministries of Ecology and Energy.

Market conditions in Kazakhstan continue to look bleak into early 1999. Hurricane's reliance on oil and refined product demand in depressed Kazakh markets is being addressed though continued assessment of economic alternatives for oil exports. In the second quarter of 1999, Hurricane entered into three export contracts. The first contract was signed with Standard Oil Limited, SA on April 9,

1999 and entails exporting up to 50,000 tonnes per month of crude by train through Russia to the Black Sea. The price is tied directly to Brent and is exempt from VAT. First shipments occurred in the second half of May with a total of 30,700 tonnes being sold in May. The other export contracts involves selling crude and mazut into China through the China Haiyu International Group. The contracts were signed on May 9, 1999 and first rail shipments of 10,000 tonnes of crude and 10,000 tonnes of mazut are scheduled for June. After that, it is anticipated that up to 50,000 tonnes per month of crude and 50,000 tonnes per month of mazut will be exported into China. Volumes and prices are negotiated on a monthly basis. Exports to China are exempt from VAT. The two oil contracts entail the export of up to an aggregate of 100,000 tonnes of oil per month, representing approximately 30% of Hurricane's anticipated production.

On the domestic market side, demand and pricing conditions in Kazakhstan for oil and refined products are expected to improve in the later part of 1999 if world prices remain at current levels. However, improvements can be expected to lag significantly behind world market benchmarks for oil and refined products.

On April 23, 1999 Hurricane announced that it had entered into a Letter of Intent with KazkommertsBank ("KKB") in which the two parties agreed to negotiate the acquisition by Hurricane of OAS Shymkentnefteorgsyntez ("ShNOS"), the company which owns the Shymkent refinery. Details of the transaction are subject to further negotiations between the parties, completion of satisfactory due diligence reviews by both parties and addressing Hurricane's long term debt position.

In relation to Hurricane's long term debt, the interest payment that was due on May 1, 1999 for the US $105 million 11¾% Senior Unsecured Note Issue due November 2004 was not paid. Also the interest payment due June 1, 1999 for the Canadian $110 million 11% Senior Unsecured Note Issue due March 2002 was not paid.

On May 14, 1999 Hurricane and its wholly owned subsidiary, Hurricane Overseas Services Inc., obtained an Order from the Court of Queen's Bench of Alberta, Judicial District of Calgary, under the *Companies' Creditors Arrangement Act* ("CCAA"). The CCAA Order permits the Company the opportunity to implement its restructuring plan and stays all legal proceedings for an initial period of thirty days. The plan is expected to provide for full conversion of the debt to equity, the acquisition of ShNOS, and new equity infusions. On June 11, 1999 the Court has extended the order to September 30, 1999 providing Hurricane files its plan for restructuring by July 22, 1999. Hurricane and ShNOS are completing due diligence.

1998 OPERATING HIGHLIGHTS

Average Daily Production – bopd	52,967
Total Production – millions of barrels	19.33
Wells Drilled on Hurricane Operated Lands	
Kumkol South ……………………….	12
South Kumkol ……………………….	8
Qyzylkiya, Aryskum, & Maibulak ……	0
Hurricane Exploration ………………	3
TOTAL ……………………………….	23
Wells Drilled on Joint Venture Lands	
Kumkol-LukOil JV (Kumkol North) …	7
Kazgermunia JV ………………………	2
Number of Producing Wells as at Dec 31 (1)	209
Land Holdings – acres (2)	
Gross Licensed Field Area…………..	396,145
Exploration License Area…………..	455,672

1. Producing fields include Kumkol South, Kumkol North and South Kumkol.
2. Total gross acres of which Hurricane has 100 per cent interest.

AVERAGE DAILY PRODUCTION PER QUARTER – Net to Hurricane (bopd)

	1998
Quarter ending March 31	55,403
Quarter ending June 30	57,812
Quarter ending September 30	55,622
Quarter ending December 31	43,137
For the full year	52,967

Management's Discussion and Analysis

The following discussion and analysis should be read in conjunction with Hurricane's Consolidated Financial Statements and any other financial information included herein. Hurricane maintains its accounting records and publishes its statutory financial statements in accordance with Canadian corporate and securities regulations. All figures are expressed in US dollars.

This discussion contains certain forward-looking statements within the meaning of US federal securities laws. Actual results and the timing of certain events could differ materially from those projected in the forward-looking statements due to a number of factors.

Overview

Hurricane Hydrocarbons Ltd. is an independent international energy company based in Calgary, Canada engaged in the exploration for, development and production of oil and natural gas in Kazakhstan. Hurricane owns interests in eight fields, all of which are located in the South Turgai Basin of central Kazakhstan.

Recent Events

During the year ended December 31, 1998, Hurricane experienced a number of financial and operational difficulties, including a reduction in its oil production volumes in Kazakhstan and a significant reduction in the price it was receiving in Kazakhstan for its crude oil production. This resulted in a severe shortage of cash resources in the last half of 1998 and the first few months of 1999. This cash flow shortage resulted in the non-payment by the Company of some of its trade debt and employee wages as well as the default in the payment of interest on a portion of its long-term debt on May 1, 1999. As a result, on May 14, 1999, Hurricane and its wholly owned subsidiary, Hurricane Overseas Services Inc. ("HOSI"), obtained an Order from the Court of Queen's Bench of Alberta, Judicial District of Calgary, under the *Companies' Creditors Arrangement Act* (the "CCAA Order").

The CCAA Order permits Hurricane the opportunity to negotiate and implement its proposed restructuring plan. The plan currently provides for the full conversion of Hurricane's long-term debt obligations (having a principal amount at December 31, 1998 of US$176,871,937) to common shares, the acquisition of OAO Shymkentnefteorgsyntez ("ShNOS"), the company which owns the Shymkent Refinery pursuant to a Letter of Intent entered into on April 23, 1999 between Hurricane and JSC KazkommertsBank and a new equity infusion. Extensive due diligence and negotiations are currently being conducted by all parties to these transactions. The plan is subject to satisfactory completion of such due diligence, legal documentation and stakeholder and regulatory approvals.

Change in Fiscal Year

Hurricane changed its fiscal year end from June 30 to December 31 effective for the six month transition period ended December 31, 1997 (Transition 97). The fiscal year was changed in order to present a fiscal year that is standard for most oil and gas companies of comparable size to Hurricane. Hurricane had completed the Hurricane Kumkol Munai (HKM) acquisition effective November 30, 1996. The fiscal 1997 results, being June 30, 1996 to June 30, 1997, include the results of HKM for only the seven months period following the effective date of the HKM acquisition.

Accounting Policies

The financial results for 1998 have been prepared on the basis of accounting principles applicable to a "going concern". The ability of Hurricane to continue as a "going concern" is dependant upon a number of factors which include resolution of operating issues surrounding the refining and marketing of its production and modification of the Company's capital structure. Should the "going concern" assumptions no longer be appropriate, the financial information contained herein does not give effect to adjustments that would be necessary. In such a case, the amounts realizable with respect to its assets may be materially less.

Hurricane follows the full cost method of accounting for oil and natural gas properties. Under this method, all costs relating to the exploration for and the development of, oil and natural gas properties are capitalized. The capitalized costs are depleted and depreciated on a unit-of-production method, based on proved reserves before royalties.

Costs of exploration in new cost centres, together with related land costs, are excluded from costs subject to depletion until it is determined whether or not proved reserves are attributable to the properties or if impairment has occurred.

Capitalized costs are subject to a cost recovery test (the "ceiling test"). Under this test, costs accumulated in each cost centre are limited to the estimate of future net revenues from production of estimated proved reserves at prices and costs in effect at the year end, plus the cost of major developments and unproved properties less any impairment of such costs and less estimated future interest expense, administrative costs, future site restoration costs and income taxes attributable to those operations. If the net carrying cost exceeds the ultimate recoverable amount as computed under the test, a writedown is recorded.

Year ended December 31, 1998 Compared to Six Months ended December 31, 1997

The 1998 financial results were characterised by a severe reduction in oil prices in the second half of the year in a product saturated market in Kazakhstan. The general decline in world oil prices which commenced in late 1997 negatively impacted oil prices in the Kazakhstan market starting in May, 1998. Economic difficulties emanating from Russia in the second half of 1998 caused a decline in demand in Kazakhstan as well as increased competition from Russian producers of oil products. Prices continued to decline until well into 1999 and have only recently started to show signs of a modest recovery.

Production

Production volumes were reduced from 55.6 thousand barrels per day in the third quarter of 1998 to 43.1 thousand barrels per day in the fourth quarter as a result of an extended maintenance shutdown at the Shymkent refinery during October and November. Sales volumes declined even further from an average of 59 thousand barrels per day in the third quarter of 1998 to 37 thousand barrels per day in the fourth quarter. Production for the 1998 fiscal year was 19.3 million barrels of oil compared to 8.6 million barrels during Transition 97. This growth reflected the Company's focus during 1997 and the first half of 1998 on increasing the productive capacity of the Kumkol fields.

Sales

Average realized prices during 1998 were \$8.95 per barrel on total sales of 19.2 million barrels compared to \$10.64 per barrel on a total of 8.8 million barrels during Transition 97. Prices during the fourth quarter of 1998 were \$5.87 per barrel compared with \$9.61 per barrel during the first nine months reflecting a steady decrease during the second half of the year.

Production Expenses

In spite of a focus on cost control and a general reduction in activity levels towards the end of 1998, the decline in volumes of oil sold resulted in continued high levels of fixed production expense and general and administrative costs on a per barrel basis. Production expenses for 1998 were \$75.5 million or \$3.93 per barrel of oil sold compared to \$28.4 million or \$3.22 per barrel during Transition 97. This increase reflected higher pipeline tariffs and an increased percentage of oil being processed through the refinery during 1998.

Provision for Doubtful Accounts

Difficult economic conditions in Kazakhstan and increased competition in the market place resulted in a general decline in the credit quality of Hurricane's accounts receivable. This led the Company to increase its reserve for doubtful accounts by \$15.0 million during 1998. This reserve was offset by \$2.5 million of Value Added Tax ("VAT") associated with the sales which gave rise to those accounts receivable and which is recoverable from VAT payment obligations.

Royalties
Most of the Company's royalties are calculated on a sliding scale based on annual production volumes. As a result, royalty rates declined in the fourth quarter of 1998 due to the significant drop in production volumes. Royalties for 1998 were $12.2 million or $0.63 per barrel of oil sold, compared to $6.9 million or $0.78 per barrel for Transition 97.

General and Administrative Expenses
General and administrative expenses for 1998 were $41.0 million compared to $13.7 million during Transition 97. A large part of the increase was attributable to a lower level of activity related to capital projects during 1998 as projects were curtailed or discontinued as economic conditions worsened. This resulted in the costs of related support services, which had previously been capitalized, being written off as period costs during 1998.

Interest and Deferred Financing Costs on Long-Term Debt
Interest and deferred financing costs were $30.5 million during 1998 compared to $$6.9 million during Transition 97. Part of the increase was due to the fact that the US Notes were issued in late November 1997 and so were reflected for only a portion of Transition 97. The other significant increase was attributable to $7.5 million of deferred financing costs which were written off as a result of the reclassification of the long-term debt to current liabilities. In addition, the unamortized discount on the Canadian Notes related to the value of the Series 5 Warrants of $1.1 million has been fully recognized as expense. The reclassification occurred as a consequence of the default under the two note indentures related to the application for the CCAA Order on May 14, 1999.

Depletion and Depreciation and Ceiling Test Write-Down
The most significant item on the income statement for 1998 was the ceiling test write-down of $173.4 million. At the end of the third quarter, the Company had reported that, based on oil prices in effect during the year up to September 1998, a ceiling test write-down was not required but that if prices in effect at September 30, 1998 were used, a substantial write-down would have been required. By the end of 1998, oil prices in Kazakhstan had dropped to less than $5.00 per barrel and as a result, although there had been no significant adjustments to reserves, the calculation of the ceiling test under Canadian Generally Accepted Accounting Principles resulted in a write-down of $173.4 million. This represented the full amount of the depletable pool and was in addition to the regular charge of $42.8 million based on the normal application of the unit-of-production method in 1998.

Foreign Exchange Gain
The foreign exchange gain of $5.4 million in 1998 represents a number of items including the recognition of the balance of the deferred gain of $6.5 million related to the Canadian Notes due 2002 which were reclassified on the occurrence of the Event of Default as described above.

Income Taxes and Government Charges
In spite of the significant loss sustained during the year, taxes and other governmental charges totalled $22.6 million. This amount included charges related to 1997 filings which in some cases have been actively appealed by the Company. If the Company is successful in its appeals, the consequent reductions will likely be applied against future liabilities. In light of the uncertainties in the timing of recoveries, the Company has chosen to provide for these items at this time.

Net Income
The combination of these factors resulted in a loss for the year of $229.3 million or $5.18 per share on 44.2 million shares outstanding compared to a net income of $15.8 million or $0.37 per share on 42.8 million shares outstanding during Transition 97. The 1998 loss eliminated the opening retained earnings and created a retained earnings deficit of $199.0 million at year end.

Cash Flow from Operations
The 1998 cash flow deficiency from operations was $11.9 million or $0.27 per share compared to a cash flow from operations of $32.0 million or $0.75 per share for Transition 97.

Assets
The capital expenditures of $113.7 million and the combination of the depletion and depreciation charges of $42.8 million and the ceiling test write-down left a balance for capital assets of $76.8 million representing the non producing and depreciable assets of the Company. Current assets were $47 million at year end including $29.8 million of accounts receivable and $13.1 million of inventory.

Liquidity and Cash Resources
The shortage of cash resources which became more severe towards the end of 1998 was reflected in an increase in accounts payable from $22.8 million at December 31, 1997 to $45.2 million at the end of 1998. This cash shortage has continued to worsen during the first half of 1999 and has caused the Company to default on the payment of interest on its U.S. dollar denominated long-term debt on May 1, 1999. The Company subsequently filed for protection from its creditors under the Companies' Creditors Arrangement Act. This filing constitutes an act of default under the trust indentures governing both of its outstanding long-term debt issues. For this reason, the long-term debt of $175.8 million is categorised as a current liability on the balance sheet. As a result the total of current liabilities was $223.8 million. Before the effect of the long-term debt reclassification, the Company's working capital deficit was approximately $1.8 million.

Shareholders' Equity
The retained earnings deficit of $199.0 million has resulted in a negative shareholders' equity of $93.9 million at December 31, 1998.

Transition 97 Compared to Six Months Ended June 30, 1997
As a result of the HKM acquisition effective November 30, 1996 and the fact that, effective December 31, 1997, Hurricane changed its fiscal year end from June 30 to December 31, the result of operations for the six months ended December 31, 1997 (Transition 1997) are not directly comparable with those for the fiscal year ended June 30, 1997. During the month of December 1996, a large part of the operations of HKM, in particular the marketing activities, were conducted in accordance with arrangements entered into by the former owners and management.

Prior to the HKM acquisition, Hurricane's operations were restricted to a minimal oil and gas production operation in Canada and the funding of its 20 per cent interest in the Turan Petroleum Joint Enterprise. The assets acquired in the HKM acquisition have accounted for virtually all of the revenues and expenses since that date. For these reasons, the most meaningful period for comparison with Transition 1997 is the six month period ended June 30, 1997 (Comparative Period). The results for the Comparative Period were not audited and have been compiled in US dollars from the unaudited quarterly reports issued by Hurricane.

Production
Production for the six months ended December 31, 1997 was approximately 8.6 million barrels compared with 8.0 million barrels in the six months ended June 30, 1997. In Transition 1997, the production from Kumkol South, which is 100 per cent owned and operated by Hurricane, was approximately 7.0 million barrels compared to 6.6 million barrels in the Comparative Period. Production attributable to Hurricane from Kumkol North, in which the Company has a 50 per cent interest through Kumkol-LUKoil, was approximately 1.6 million barrels in the six months ended December 31, 1997 compared to 1.4 million in the six months ended June 30, 1997. Production from South Kumkol which is also 100 per cent owned and operated by Hurricane, and which was brought on stream in December of 1997, was approximately 7,000 barrels in Transition 1997.

Sales
Sales volumes for the six months ended December 31, 1997 increased by 27.5 per cent to 8.8 million barrels compared to 6.9 million barrels in the Comparative Period. As a result of the increased sales volumes, revenue from oil sales in Transition 1997 were $93.9 million compared to $73.0 million for the six months ended June 30, 1997. Prices for crude oil and refined products remained relatively constant throughout the 1997 calendar year.

Interest Income
Interest income in Transition 1997 was $0.9 million compared to $0.6 million in the Comparative Period as a result of the investment of the net proceeds from the issuance of the 11 ¾ per cent US Notes.

Production Expenses
Production expenses for the six months ended December 31, 1997 were $28.4 million or approximately $3.22 per barrel of oil sold compared to $17.8 million or $2.59 per barrel of oil sold in the Comparative Period. The principal reason for the increase on a per barrel basis was a downward adjustment in the carrying value of inventory which was made at the year end to reflect the lower prices being received for heating oil in the winter of 1997-98.

Royalties
Royalties for the six months ended December 31, 1997 were $6.9 million or $0.78 per barrel of oil sold compared with $3.5 million or $0.50 per barrel of oil sold in the Comparative Period. Hurricane enjoyed a royalty holiday in respect of the production from Kumkol

South from the date of the HKM acquisition to April 21, 1997. This royalty holiday resulted in the lower average royalty rate during the six months ended June 30, 1997.

General and Administrative Expenses

General and administrative expenses for the six months ended December 31, 1997 were $13.7 million compared with $14.1 million in the Comparative Period. General and administrative expenses include the costs, net of relative revenues, for many of the non-oil divisions of HKM such as the transportation division and the agricultural division. As a result, this item is subject to fluctuation from time to time. On a per barrel basis, general and administrative expenses declined from $2.06 to $1.56 reflecting the increased sales volumes during the six months ended December 31, 1997 versus the six months ended June 30, 1997.

Interest

Interests costs for the six months ended December 31, 1997 were $6.9 million compared to $2.6 million for the Comparative Period. The increase was attributable to the increase in Hurricane's level of debt resulting from the issuance of the US notes. Interest costs for the six months ended June 30, 1997 reflect only the Canadian notes which Hurricane had issued in March 1997.

Depletion and Depreciation

Depletion and depreciation for the six months ended December 31, 1997 was $15.9 million compared to $14.3 million in the Comparative Period. The rates per barrel were $1.81 and $2.08 respectively. The rate per barrel declined for the three months ended September 30, 1997 from $2.08 to $1.64 as a result of an upward revision in reserves as of September 1, 1997. The significant upward revision in reserves as at January 1, 1998 was accompanied by a significant increase in the estimated cost of developing and producing the reserves. This resulted in an increase in the rate of depletion per barrel which partly offset the previous reduction.

Income Tax

The charges for income tax represents current and deferred Kazakhstani corporate tax in respect of the profits of HKM. The charge for income tax for the six months ended December 31, 1997 was $7.1 million or 31 per cent of income before tax, compared to $9.4 million or 44 per cent for the six months ended June 30, 1997. During Transition 1997, certain structures and arrangements were put in place to charge HKM with costs which had been incurred on behalf of HKM by Hurricane Hydrocarbons Ltd. These arrangements resulted in a reduction in the consolidated effective tax rate.

Net Income

The net income for Transition 1997 was $15.8 million ($0.37 per share based on a weighted average of 42.8 million shares outstanding during the period) compared with $11.9 million for the Comparative Period and $12.4 million for Fiscal 1997 (equivalent to $0.39 per share calculated based on 31.8 million shares being the weighted average number of shares outstanding during Fiscal 1997).

Cash Flow from Operations

Cash flow from operations was $32.0 million for the six months ended December 31, 1997 ($0.75 per share calculated based on 42.8 million shares outstanding during the period) compared to $26.7 million for the six months ended June 30, 1997 and $30.2 for Fiscal 1997 (equivalent to $0.95 per share calculated based on 31.8 million shares being the weighted average number of shares outstanding during Fiscal 1997).

RISKS

Commodity Price Risks

To date, Hurricane has sold virtually all of its production in the domestic market in Kazakhstan at prices which, for the most part have been significantly below the equivalent world market price, adjusted for transportation and quality differentials. In the future, Hurricane plans to increase production levels and to sell the incremental production in export markets at prices which would be more closely tied to world market prices. At that time, fluctuations in world prices will have a more direct impact on Hurricane's financial results. To date, Hurricane has not used hedging programs to protect against fluctuations in oil prices because of the lack of correlation between Hurricane's sales prices and benchmark world market prices.

Foreign Exchange Risks

Hurricane Hydrocarbons Ltd. reports in US dollars and has operations which use US dollars, Canadian dollars and Kazakhstani tenge. Hurricane posts its sales prices in US dollars and although sales are, for the most part, made in tenge, payment is usually made before

delivery so that the exposure to loss through a reduction in value of the tenge is minimized. Most of Hurricane's operating costs are denominated in tenge, and thus tenge bank balances are maintained in addition to US and Canadian dollar balances. There is no significant forward market in the tenge, accordingly, no real hedging instruments are available. Hurricane's exposure to changes in the value of the tenge is restricted to the net amount of the tenge bank balance and the tenge accounts receivable and payable is partly offset by the ongoing requirement for tenge for regular operating costs.

In March, 1977, Hurricane issued five year Canadian dollar notes in an aggregate principal amount of Cdn $110 million. This was equivalent to approximately $80 million at the time of issue and at December 31, 1997 was equivalent to approximately $71.9 million. Hurricane has elected not to hedge this exposure, and at this time, is exposed to changes in the value of the Canadian dollar against the US dollar. The Company continues to review its alternatives in this regard and may choose to hedge the exposure at some time in the future.

Risks of Doing Business in Kazakhstan

Hurricane's operations and assets are located in the Republic of Kazakhstan, a member of the Commonwealth of Independent States. Kazakhstan has been independent of the former Soviet Union since December 16, 1991 and is ruled by a President and a Parliament which are elected by the general population. There are risks inherent in operating in a country which has been independent for such a relatively short period of time and which does not yet have an extended history of political and economic stability. In light of this, Hurricane has purchased an insurance policy to protect itself from certain of the political risks to which it is exposed.

Business Concentration Risk

All of Hurricane's oil production is delivered by pipeline to the Shymkent Refinery in Southern Kazakhstan. Hurricane has the option of selling the crude to ShNOS, the owners of the refinery, or paying ShNOS a fee to refine the oil and selling the refined products in competition with ShNOS and others. The processing fee has been set at $20 per ton in a contract which expires in September 1999. Beyond that date, there is no assurance that the fee will not change or that processing services will continue to be made available to Hurricane. During 1998, Hurricane was unsuccessful in its attempt to persuade the Kazakhstan Anti-Monopoly Commission to reduce the fee which ShNOS is charging for the processing of Hurricane's oil. As a result of these factors, Hurricane may be subjected to increased costs and to the potential of receiving non-competitive prices for its crude oil sales.

Year 2000 Compliance

Due to the recent purchase and installation of the Company's information systems, Hurricane and its subsidiaries have no material year 2000 exposure. All business applications, technical systems, desktop tools and operating systems currently in use by Hurricane in Calgary, Almaty and Kyzylorda are in full compliance with the year 2000 issue. These systems were purchased and installed in 1997.

Hurricane has a centralized Information Systems department structure through which all information technology purchases flow. This purchasing and control system was in place for all past purchases and assures the Company that all future purchases meet established standards such as year 2000 compliance. Furthermore, much of Hurricane's data prior to 1997 was not maintained electronically. Therefore, the year 2000 will have no material effect on historical data. Hurricane maintains no integrated systems with third parties or suppliers. As a result, management does not anticipate that Hurricane will incur significant operating expenses or be required to invest heavily in computer systems improvements to be year 2000 compliant. Nor does the company anticipate that business operations will be disrupted or that its customers will experience an interruption of deliveries or services as a result of the millennium change. Hurricane has inquired of its two major service providers as to their compliance with the year 2000 issue and have been advised by them that they are year 2000 compliant. Hurricane has not been able to obtain independent verification of this assertion.

Management Report

All information in this annual report is the responsibility of management. The financial statements necessarily include amounts that are based on estimates, which have been objectively developed by management using all relevant information. The financial information contained elsewhere in this report has been reviewed to ensure consistency with the financial statements.

Management maintains systems of internal accounting control designed to provide reasonable assurance that assets are safeguarded, transactions are properly authorized and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Audit Committee of the Board of Directors, comprised of one management and two non-management directors, has reviewed the financial statements with management and Deloitte & Touche. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

R.P. Norris

RICHARD P. NORRIS
Vice President Finance and
Chief Financial Officer

FREDERICK A. YOUCK
Vice President Administration
and Corporate Secretary

Consolidated Financial Statements of

HURRICANE HYDROCARBONS LTD.

December 31, 1998

Independent Auditors' Report

To the Shareholders of

HURRICANE HYDROCARBONS LTD.:

We have audited the consolidated balance sheets of Hurricane Hydrocarbons Ltd. (the "Corporation") as at December 31, 1998, December 31, 1997 and June 30, 1997, and the consolidated statements of income (loss) and retained earnings (deficit) and changes in financial position for the year ended December 31, 1998, the six months ended December 31, 1997 and the year ended June 30, 1997. These consolidated financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1998, December 31, 1997 and June 30, 1997, and the results of its operations and the changes in its financial position for the year ended December 31, 1998, the six months ended December 31, 1997 and the year ended June 30, 1997 in accordance with generally accepted accounting principles in Canada.

Deloitte & Touche LLP

Chartered Accountants

Calgary, Alberta
May 25, 1999
(June 11, 1999 as to Note 13)

HURRICANE HYDROCARBONS LTD.

Consolidated Statements of Income (Loss) and Retained Earnings (Deficit)
(Expressed in United States Dollars)

	Year Ended December 31 1998	Six Months Ended December 31 1997	Year Ended June 30 1997
REVENUE			
Sales	$ 171,752,342	$ 93,907,303	$ 84,473,927
Interest and other income	4,196,802	896,875	700,349
	175,949,144	94,804,178	85,174,276
EXPENSES			
Production	75,491,870	28,444,098	23,604,851
Provision for write-downs	12,500,000	—	—
Royalties	12,176,625	6,850,504	3,471,509
General and administrative	41,070,949	13,728,921	15,990,654
Interest and financing costs on long-term debt (note 7)	30,541,244	6,902,840	2,645,356
Depletion and depreciation	42,779,328	15,932,966	17,049,249
Ceiling test write-down	173,436,952	—	—
Foreign exchange (gain) loss (note 7)	(5,426,123)	31,594	(65,139)
	382,570,845	71,890,923	62,696,480
INCOME (LOSS) BEFORE INCOME TAXES	(206,621,701)	22,913,255	22,477,796
INCOME TAXES AND GOVERNMENT CHARGES (note 9)			
Current provision	23,004,404	7,069,467	9,609,725
Deferred provision (recovery)	(360,000)	—	360,000
	22,644,404	7,069,467	9,969,725
NET INCOME (LOSS)	(229,266,105)	15,843,788	12,508,071
RETAINED EARNINGS (DEFICIT), BEGINNING OF PERIOD	28,230,441	12,418,403	(57,766)
Reduction of retained earnings – normal course issuer bid (note 8)	(190,530)	—	—
Preferred share dividends	(60,000)	(31,750)	(31,902)
RETAINED EARNINGS (DEFICIT), END OF PERIOD	$(201,286,194)	$ 28,230,441	$ 12,418,403
INCOME (LOSS) PER SHARE (note 12)	$ (5.18)	$ 0.37	$ 0.39
Weighted average number of shares Outstanding	44,242,138	42,825,862	31,802,015

HURRICANE HYDROCARBONS LTD.

Consolidated Balance Sheets
(Expressed in United States Dollars)

	As At December 31 1998	As At December 31 1997	As At June 30 1997
ASSETS			
CURRENT			
Cash and cash equivalents	$ 1,466,346	$ 25,633,922	$ 22,043,270
Short-term investments	—	77,261,540	—
Accounts receivable	29,827,059	42,445,652	61,080,826
Inventory (note 4)	13,092,328	16,969,592	20,071,677
Prepaid expenses	2,749,253	3,378,667	868,207
	47,134,986	165,689,373	104,063,980
Long-term accounts receivable (note 5)	3,078,000	—	—
Notes and loans receivable (note 5)	2,669,504	2,901,063	492,802
Capital assets (note 6)	76,804,953	178,764,362	147,218,526
Deferred financing costs, net of accumulated amortization	—	7,943,103	3,787,349
	$129,687,443	$355,297,901	$255,562,657
LIABILITIES			
CURRENT			
Accounts payable and accrued liabilities	$ 45,155,396	$ 22,810,411	42,097,395
Prepayments for refined products	974,876	11,574,813	—
Taxes payable and accrued	1,870,814	5,742,872	19,538,058
Long-term debt – reclassified (notes 1 and 7)	176,871,937	—	—
	224,873,023	40,128,096	61,635,453
Long-term debt (notes 1 and 7)	—	180,499,440	77,978,088
Provision for future site restoration costs	719,395	439,610	256,137
Deferred foreign exchange gain	—	2,796,904	338,873
Deferred income taxes	—	360,000	360,000
Preferred shares of subsidiary (note 3)	136,000	136,000	136,000
	225,728,418	224,360,050	140,704,551
COMMITMENTS AND CONTINGENCIES (notes 1, 11 and 13)			
SHAREHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)			
Share capital (note 8)	105,245,219	102,707,410	102,439,703
Retained earnings (deficit)	(201,286,194)	28,230,441	12,418,403
	(96,040,975)	130,937,851	114,858,106
	$129,687,443	$355,297,901	$255,562,657

APPROVED BY THE BOARD OF DIRECTORS

LOUIS W. MacEACHERN
Director

FREDERICK A. YOUCK
Director

HURRICANE HYDROCARBONS LTD.

Consolidated Statements of Changes in Financial Position
(Expressed in United States Dollars)

	Year Ended December 31 1998	Six Months Ended December 31 1997	Year Ended June 30 1997
CASH PROVIDED BY (USED IN):			
OPERATING ACTIVITIES			
Net income (loss)	$(229,266,105)	$ 15,843,788	$ 12,508,071
Items not affecting cash:			
Depletion and depreciation	42,779,328	15,932,966	17,049,249
Ceiling test write-down	173,436,952	—	—
Other non-cash charges	(573,470)	252,130	270,133
Deferred income taxes	(360,000)	—	360,000
Deferred financing costs and note discount (note 7)	8,589,359	—	—
Deferred foreign exchange gain (note 7)	(6,497,193)	—	—
Cash flow (deficiency) from operations	(11,891,129)	32,028,884	30,187,453
Changes in non-cash operating working capital items	99,181,801	(79,542,098)	(27,119,726)
	87,290,672	(47,513,214)	3,067,727
FINANCING ACTIVITIES			
Proceeds from issue of share capital, net of share issuance costs	2,347,279	267,707	14,535,692
Proceeds from issue of special warrants, net of issuance costs	—	—	76,027,994
Proceeds on issue of long-term debt, net of issuance costs	—	100,571,500	76,061,854
Preferred share dividends	(60,000)	(31,750)	(31,902)
Repayment of notes receivable	—	—	62,122
Funds provided from financing	2,287,279	100,807,457	166,655,760
INVESTING ACTIVITIES			
Acquisition of OJSC Hurricane Kumkol Munai (note 3)	—	—	(124,666,000)
Cash on hand in OJSC Hurricane Kumkol Munai at date of acquisition (note 3)	—	—	1,993,000
	—	—	(122,673,000)
Capital expenditures, net of dispositions	(113,977,086)	(47,295,330)	(27,865,514)
Investment and loans receivable	231,559	(2,408,261)	(492,802)
Funds used for investing	(113,745,527)	(49,703,591)	(151,031,316)
INCREASE (DECREASE) IN CASH	(24,167,576)	3,590,652	18,692,171
CASH POSITION, BEGINNING OF PERIOD	25,633,922	22,043,270	3,351,099
CASH POSITION, END OF PERIOD	$ 1,466,346	$ 25,633,922	$ 22,043,270

HURRICANE HYDROCARBONS LTD.

Notes to Consolidated Financial Statements
(Expressed in United States Dollars)

1. BASIS OF PRESENTATION

The consolidated financial statements have been presented using accounting principles applicable to a going concern, which assumes that Hurricane Hydrocarbons Ltd. ("Hurricane" or the "Corporation") will continue operations in the foreseeable future and be able to realize assets and satisfy liabilities in the normal course of business. The following matters cast doubt upon the validity of the going concern assumption:

- Revenues have been severely impacted by both the reduction in prices which have been realized on the sales of crude oil and refined products and reduction of sales volumes. As a result of reduced revenues, various unanticipated tax payments, increased refining costs and difficulties in receiving timely collection of accounts receivable, operating cash flows have been negative. The Corporation has been unable to satisfy its accounts payable and salary obligations as they became due.

- The Corporation has a working capital deficiency at December 31, 1998 of $177,738,037 including long-term debt reclassified as current liabilities.

- The Corporation has, subsequent to year end, been unable to make interest payments on its long-term debt, resulting in defaults under the terms of that debt. As a result, the debt repayment may be demanded prior to maturity.

- The Corporation has determined that it was necessary to seek protection under the Companies' Creditors Agreement Act ("CCAA") in order to have an opportunity to restructure its financial affairs.

The Corporation's ability to continue as a going concern is dependent upon some or all of the following factors:

- The ability of the Corporation to restructure its financial affairs including the resolution of the default condition of the long-term debt, with the result that protection under CCAA would no longer be required.

- The improvement of operating results through increased sales volumes and net returns on sales of crude oil and refined products. This involves market demand and price improvements, greater access to international markets and improvements in the Corporation's cost structure, in general and, specifically, with respect to refined products.

- Completion of a business combination with the company which owns and operates the refinery which processes the Corporation's crude oil.

- Raising new financing in the form of debt or equity.

- Successful resolution of certain taxation matters with Kazakhstan taxation authorities.

If the going concern assumption were not appropriate for these financial statements, significant adjustments would be necessary to the carrying values of assets and liabilities, the reported net loss and the balance sheet classifications.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

Hurricane is an independent international energy corporation engaged in the acquisition, exploration, development and production of oil, principally in the Republic of Kazakhstan. Until the fall of 1996, all of the Corporation's operations were conducted in western Canada.

The consolidated financial statements of Hurricane have been prepared in accordance with generally accepted accounting principles in Canada and include the accounts of the Corporation, which is incorporated under the laws of Alberta, together with the accounts of its subsidiaries which are incorporated under the laws of Canada, Cyprus or Kazakhstan.

As more fully explained in note 3, effective November 30, 1996, the Corporation acquired all of the Common Shares of GAO Yuzhneftegaz, now known as OJSC Hurricane Kumkol Munai ("HKM") from the Republic of Kazakhstan. Accordingly, the consolidated financial statements for the year ended June 30, 1997, as presented, include the operations of HKM as at and for the seven months ended June 30, 1997. Hurricane's activities in Kazakhstan account for substantially all of the revenues, income and assets as reported in the consolidated financial statements from the date of acquisition of HKM.

Change in year end

In 1997, the Corporation changed its year end from June 30 to December 31.

Joint ventures

Certain of Hurricane's activities are conducted jointly with others through both incorporated and unincorporated joint ventures. Accordingly, these consolidated financial statements reflect Hurricane's proportionate interest in such activities.

Foreign currency translation

Effective June 30, 1997, the Corporation has chosen to report in United States dollars. Prior years' financial statements previously expressed in Canadian dollars have been translated to United States dollars using the rate of exchange in effect at June 30, 1996.

Foreign currency amounts, including those of foreign subsidiaries, are expressed in United States dollars using the temporal method as follows:

- Monetary assets and liabilities — at the rate in effect at year end;
- Other assets and liabilities — at historical rates; and
- Revenues and expenses — at the average exchange rates during the period, except for provisions for depletion and depreciation which are translated on the same basis as the related assets.

Gains or losses resulting from such conversions are charged to operations except that gains or losses on conversion to United States dollars of long term monetary assets and liabilities are deferred and amortized over the remaining lives of the assets or liabilities. Upon reclassification of long-term debt to current (note 7), the Corporation recognized previously deferred foreign exchange gains as income in the year ended December 31, 1998.

Cash and cash equivalents

Cash and cash equivalents includes term-deposits with original maturity terms not exceeding 90 days.

Short-term investments

Short-term investments consist of investments in high-grade corporate bonds and government treasury bills with original maturity terms ranging between 91 days and one year. These securities are recorded at their year end market values, with resulting unrealized holding gains or losses recorded in interest income. The unrealized holding gain on short-term investments was $ nil at December 31, 1998 (December 31, 1997 - $786,898, June 30, 1997 - $ nil).

Inventories

Inventories of crude oil are recorded at current estimated selling price net of related expenses. Inventories of oil products and other inventories are recorded at the lower of cost and net realizable value.

Petroleum and natural gas properties

Hurricane follows the full cost method of accounting for oil and gas operations whereby all exploration and development expenditures are capitalized on a country-by-country cost centre basis. Such expenditures include land acquisition costs, geological and geophysical expenses, carrying charges for unproved properties, costs of drilling both productive and non-productive wells, gathering and production facilities and equipment and overhead expenses related to exploration and development activities. Proceeds from sales of oil and gas properties are recorded as reductions of capitalized costs, unless the cost centre's depreciation and depletion rate would change by a factor of 20% or more, whereupon gains or losses are recognized in income. Maintenance and repair costs are expensed as incurred, while improvements and major renovations to assets are capitalized.

Costs accumulated within each cost centre, including provision for necessary future development and site restoration expenditures, are depreciated and depleted using the unit-of-production method based upon estimated proved reserves before royalties. Significant development projects and expenditures on exploration properties are excluded from the depletion calculation prior to assessment of the existence of proved reserves. Costs for unproved properties and major developments are evaluated periodically for impairment.

Capitalized costs are subject to a cost recovery test (the "ceiling test"). Under this test, costs accumulated in each cost centre are limited to the estimate of future net revenues from production of estimated proved reserves at prices and costs in effect at the year end, plus the cost of major developments and unproved properties less any impairment of such costs, and less estimated future interest expense, administrative costs, future site restoration costs and income taxes attributable to those operations. If the net carrying cost exceeds the ultimate recoverable amount as computed under the test, a writedown is recorded.

The Corporation conducts activities which are not directly related to oil exploration, development and production. Such activities, which include road building, construction and other infrastructure activities, are carried on principally in support of the exploration, development and production operations of the Corporation. No value was ascribed to the assets related to such infrastructure operations at the time HKM was acquired. The entire purchase price not related to the working capital assumed, was ascribed to oil and gas properties and related equipment.

Future site restoration

The Corporation provides for future site restoration and abandonment costs using the unit-of-production method, based on total proven reserves. The provision is included with depletion and depreciation expense.

Depreciation

Depreciation is provided on other capital assets using the declining balance method at the rate of 20% per annum.

Financing charges

The costs of arranging debt financing were deferred and amortized over the term of the debt as interest expense, using the straight-line method. Upon reclassification of long-term debt to current (note 7), the Corporation expensed the previously deferred financing charges in the year ended December 31, 1998.

Long-term debt

The difference between the value ascribed to the Canadian Notes and the face value of the notes (the "Discount") is amortized as interest expense on a straight-line basis over the term of the debt (note 7). Upon reclassification of long-term debt to current (note 1), the Corporation expensed the previously unamortized Discount in the year ended December 31, 1998.

Revenue recognition

Sales of petroleum and refined products are recorded in the period in which the sale occurs. Produced but unsold products are recorded as inventory until sold.

Royalties

Royalties are recorded on the accrual basis and are paid to the government of the Republic of Kazakhstan in accordance with negotiated hydrocarbon agreements on a field-by-field basis. The Corporation's royalties, which are either fixed or are based on a sliding scale related to production in the specific field for a calendar year, vary from 3% to 15%.

Financial instruments

The Corporation has estimated the fair value of its financial instruments, which includes cash, cash equivalents, short term investments, accounts receivable, long term accounts and notes receivable, accounts payable, taxes payable and accrued taxes, accrued liabilities and long-term debt. The Corporation has used valuation methodologies and market information available as of year end and has determined that of such financial instruments, the carrying amounts approximate fair value in all cases except for loans receivable (note 5).

Financial risks

The Corporation is exposed to credit risk to the extent of non-performance by third parties in the payment of receivable amounts.

The Corporation is also exposed to foreign currency risk to the extent that transactions and balances are denominated in currencies other than United States dollars. This risk could be significant for those transactions and balances denominated in the currency of Kazakhstan, the tenge, as the currency is relatively new and has, over its history, experienced significant devaluations relative to United States dollars.

The Corporation currently negotiates the price it receives for its crude oil and refined products which it sells in Kazakhstan. Sales prices are not directly dependent on world commodity prices for crude oil.

Use of estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates are subject to measurement uncertainty. Actual results could differ from and affect the results reported in these consolidated financial statements.

3. ACQUISITION OF HKM

On August 28, 1996, the Corporation entered into a Share Sale-Purchase Agreement (the "Agreement") with the Republic of Kazakhstan for the purchase of 100% of the issued common shares of HKM, a state owned joint stock company, operating in the South Turgai Basin, located in South Central Kazakhstan.

HKM also has a single class of preferred shares outstanding which are owned by current and former employees of HKM. The preferred shares are entitled to one vote per share which represents 10.5% of the aggregate voting shares. The preferred shares are entitled to an aggregate dividend preference of approximately $60,000 per annum and are non-participating except in a liquidation of HKM, in which event the holders of the preferred shares will participate to the extent of 10.5% of net assets.

Under the terms of the Agreement, which was finalized and signed on December 12, 1996, the purchase price was $120 million. Of the purchase price, $30 million was paid on each of September 5, 1996, December 12, 1996, March 31, 1997 and April 30, 1997.

The acquisition of HKM was accounted for under the purchase method with an effective date of November 30, 1996. Hurricane's aggregate purchase price of $120,000,000 plus costs incurred by Hurricane associated with its acquisition of HKM of $4,666,000, was assigned to the assets and liabilities of HKM, including joint venture interests, as follows:

Cash		$ 1,993,000
Accounts receivable		33,428,000
Prepayments to suppliers		892,000
Inventory		6,581,000
Capital assets		130,178,000
		173,072,000
less:		
Accounts payable and accrued liabilities	$ 48,270,000	
Preferred shares of subsidiary	136,000	48,406,000
Aggregate consideration		$124,666,000

4. **INVENTORY**

Inventory consists of the following:

	December 31 1998	December 31 1997	June 30 1997
Raw materials and supplies	$ 4,999,415	$ 9,469,592	$ 6,629,947
Crude oil and refined products	8,092,913	7,500,000	13,441,730
	$ 13,092,328	$16,969,592	$ 20,071,677

5. **LONG-TERM ACCOUNTS RECEIVABLE AND NOTES AND LOANS RECEIVABLE**

Long-Term Accounts Receivable

Accounts receivable for which settlement is not anticipated in the ensuing year have been classified as long-term.

Notes Receivable

During 1994 the Corporation advanced funds to certain officers and directors to enable them to purchase Class A common shares from treasury pursuant to share options. The advances are non-interest bearing with no fixed terms of repayment, supported by demand promissory notes. The Corporation does not anticipate demanding any repayment on these notes during calendar 1999; consequently, these notes are reflected as non-current assets. Due to the terms of the notes, the fair value cannot be determined.

Investment – Advance to Transfer Terminal

During 1997, the Corporation entered a joint venture agreement for the construction and operation of an oil transfer terminal (the "Transfer Terminal") on the Kazakhstan/Chinese border. At December 31, 1997 the Corporation had advanced $1,000,020 towards the joint venture.

During 1998, substantial construction of the Transfer Terminal commenced and the Investment – Advance to Transfer Terminal was invested in Transfer Terminal capital-in-progress. The Corporation has consolidated the accounts of this joint venture at December 31, 1998.

Loan Receivable

The Corporation, at December 31, 1998, had a loan outstanding in the amount of $2,225,000 (December 31, 1997 - $1,425,000, June 30, 1997 – nil) for the purpose of securing a contract for required marketing and related services. The contract expires November 30, 1999 and is renewable for a further two year term. The Corporation is committed to loan a maximum of $2,600,000. This loan is secured by 100% of the common voting shares of the borrower and is due December 31, 2001, including accrued interest at the rate of 11.45%.

Investment and loans receivable includes the following:

	December 31 1998	December 31 1997	June 30 1997
Notes receivable	$ 444,504	$ 476,043	$ 492,802
Investment – Advance to Transfer Terminal	—	1,000,020	—
Loan receivable	2,225,000	1,425,000	—
	$ 2,669,504	$ 2,901,063	$ 492,802

6. **CAPITAL ASSETS**

	December 31, 1998		
	Cost	**Accumulated Depletion and Depreciation**	**Net Book Value**
Oil and gas properties and equipment			
Canada	$ 1,282,934	$ 1,282,934	$ —
Kazakhstan	299,298,951	247,185,951	52,113,000
	300,581,885	248,468,885	52,113,000
Other capital assets	24,763,577	71,624	24,691,953
	$ 325,345,462	$ 248,540,509	$ 76,804,953

	December 31, 1997		
	Cost	**Accumulated Depletion and Depreciation**	**Net Book Value**
Oil and gas properties and equipment			
Canada	$ 1,397,049	$ 608,886	$ 788,163
Kazakhstan	207,985,275	31,738,014	176,247,261
	209,382,324	32,346,900	177,035,424
Other capital assets	2,469,506	740,568	1,728,938
	$ 211,851,830	$33,087,468	$178,764,362

	June 30, 1997		
	Cost	**Accumulated Depletion and Depreciation**	**Net Book Value**
Oil and gas properties and equipment			
Canada	$ 1,329,186	$ 584,975	$ 744,211
Kazakhstan	160,789,753	16,266,000	144,523,753
	162,118,939	16,850,975	145,267,964
Other capital assets	2,437,562	487,000	1,950,562
	$ 164,556,501	$ 17,337,975	$ 147,218,526

Excluded from the depletable base are undeveloped properties of $52,113,000 (December 31, 1997 - $48,313,000, June 30, 1997 - $48,313,000).

7. LONG-TERM DEBT

Canadian Notes

On March 26, 1997, Hurricane issued Canadian $110 million (U.S. $80 million) of Special Warrants under a Special Warrant Indenture (the "Indenture"), dated March 26, 1997. Under the terms of the Indenture, each Special Warrant was exercisable by the holder thereof, at no additional cost, into one unit, with each unit comprised of one $1,000 principal amount Note and 45 Series 5 Warrants (see note 8(g)). In accordance with generally accepted accounting principles for compound financial instruments, Canadian $107,525,000 (U.S. $78,245,525) was ascribed to long-term debt and the remaining Canadian $2,475,000 (U.S. $1,801,048) to share capital. As of July 27, 1997, all of the Special Warrants were exercised or were deemed to have been exercised. As a result, Hurricane issued Canadian $110 million of 11% senior unsecured notes due 2002 (the "Canadian Notes") under the Indenture. As at December 31, 1998, the unamortized discount is $nil (December 31, 1997 - $1,472,080; June 30, 1997 - $1,703,187).

The Canadian Notes will mature on March 27, 2002 and all outstanding principal will be repayable on maturity. Interest on the Canadian Notes accrues at the rate of 11% per annum and is payable on June 1 and December 1 in each year through 2001, commencing June 1, 1997, with the final interest payment on March 26, 2002.

The Canadian Notes are general unsecured obligations of Hurricane and rank equally in right of payment to all existing and future unsecured debt of Hurricane not subordinated by its express terms. The Canadian Notes rank senior in right of payment to any and all existing and future subordinated debt of Hurricane. The Canadian Notes are not callable or otherwise redeemable at the option of the Corporation at any time prior to their stated maturity date.

The Canadian Notes contain certain covenants which restrict the Corporation's activities, including limitation of indebtedness, dividends, restricted payments, sale of assets, liens and related party transactions.

On May 14, 1999, the Corporation obtained an Order from the Court of Queen's Bench of Alberta, Judicial District of Calgary, under the Companies' Creditors Arrangement Act. This action constituted an event of default under the terms of the Canadian Notes and caused the principal amount of the Canadian Notes together with all associated interest and other amounts, to become immediately due and payable. As a result, the Canadian Notes have been reclassified to current liabilities (note 13).

On June 1, 1999, the Corporation failed to pay its semi-annual interest payment of $4,078,193 on the Canadian Notes.

U.S. Notes

On November 7, 1997, Hurricane issued $105 million of 11¾% senior unsecured notes due 2004 (the "U.S. Notes"). The U.S. Notes will mature on November 1, 2004 and all outstanding principal will be repayable on maturity.

Interest on the U.S. Notes accrues at the rate of 11¾% per annum and is payable on May 1 and November 1 of each year, commencing May 1, 1998.

The U.S. Notes are general unsecured obligations of Hurricane and rank equally in right of payment with all existing and future unsecured debt of Hurricane which is not subordinated by its express terms. The U.S. Notes rank senior in right of payment to any and all existing and future unsecured subordinated debt of Hurricane.

The U.S. Notes are redeemable at the option of Hurricane, in whole or in part, at any time on or after November 1, 2001 at redemption prices varying from 100% to approximately 109% of the principal amount thereof, plus accrued and unpaid interest, liquidated damages, and additional amounts, if any to the date of redemption depending on the redemption date. Notwithstanding the foregoing, any time prior to November 1, 2000, Hurricane may redeem up to 33 1/3% of the original aggregate principal amount of the U.S. Notes with the net proceeds of a public offering at a redemption price of 111 3/4% of the principal amount thereof, plus accrued and unpaid interest, liquidated damages and additional amounts, if any to the date of redemption; provided that at least 66 2/3% of the original aggregate principal amount of the U.S. Notes remains outstanding immediately after the occurrence of such redemption. The U.S. Notes also may be redeemed at the option of Hurricane, in whole but not in part, at any time at a redemption price equal to the principal amount thereof plus accrued an unpaid interest, liquidated damages and additional amounts, if any, to the redemption date in the event of certain changes in certain applicable tax laws or in official interpretations thereof.

The U.S. Notes contain certain covenants which restrict the Corporation's activities, including limitation of indebtedness, dividends, restricted payments, sales of assets, liens and related affiliate transactions.

On May 1, 1999, the Corporation failed to pay its semi-annual interest payment of $6,168,750 on the U.S. Notes. On May 14, 1999, the Corporation obtained an Order from the Court of Queen's Bench of Alberta, Judicial District of Calgary, under the Companies' Creditors Arrangement Act. This action constituted an event of default under the terms of the U.S. Notes and caused the principal amount of the U.S. Notes together with all associated interest and other amounts, to become immediately due and payable. As a result, the U.S. Notes have been reclassified to current liabilities (note 13).

Principal repayments, assuming that the Canadian Notes and U.S. Notes were to be re-paid under the originally prescribed terms of the Notes, are as follows for the five succeeding years and thereafter:

1999	$ —
2000	—
2001	—
2002	71,871,937
2003	—
Subsequent years	105,000,000
Long term debt	$ 176,871,937

As a result of the defaults under the long-term debt provisions, and the reclassification of the long-term debt as a current liability, the amortization of deferred financing charges, deferred foreign exchange gains and the discount on the Canadian Notes has been discontinued and all of the remaining unamortized amounts have been charged or credited to the Statement of Income (Loss) for the year ended December 31, 1998. Included in interest expense for the year ended December 31, 1998 is the unamortized deferred financing charges ($7,538,232) and the unamortized Discount ($1,051,127).

Foreign exchange (gain) loss includes the write off of the deferred foreign exchange gain described above of $6,497,193.

8. SHARE CAPITAL

a) Authorized share capital consists of an unlimited number of no par value Class A common shares, and an unlimited number of no par value Class B redeemable preferred shares, issuable in series.

b) Issued Class A common shares, including convertible special warrants:

	December 31, 1998		December 31, 1997		June 30, 1997	
	Number	Amount	Number	Amount	Number	Amount
Balance, beginning of period	42,900,259	$ 102,707,410	42,732,259	$ 102,439,703	13,221,973	$ 10,074,970
Convertible special warrants issued for services provided (note (d))	—	—	—	—	150,000	252,581
Stock options exercised for cash	610,000	860,506	60,000	113,112	275,500	389,761
Purchase warrants exercised for cash	1,193,000	1,876,573	108,000	173,963	5,631,514	13,894,958
Class A Special Warrants issued for Cash (note (e))	—	—	—	—	12,223,000	40,148,540
Class B Special Warrants issued for Cash (note(f))	—	—	—	—	11,230,272	40,979,808
Special Warrants issued for cash (note (g))	—	—	—	—	—	1,801,048
Shares acquired pursuant to normal course issuer bids (note (i))	(190,900)	(199,270)				
Issuance costs	—	—	—	(19,368)	—	(5,101,963)
Total issued during the period, net	1,612,100	2,537,809	168,000	267,707	29,510,286	92,364,733
Balance, end of period	44,512,359	$ 105,245,219	42,900,259	$ 102,707,410	42,732,259	$102,439,703

c) During February 1995, the Corporation completed a Cdn $4 million private placement of 2,666,666 special warrants at Cdn $1.50 each, realizing approximately Cdn $3.5 million after Underwriter's commissions and other expenses related to the issue. The Corporation also issued 120,000 special warrants to three officers of the Corporation for services rendered during the preceding fiscal year. Each special warrant entitled the holder to receive upon exercise, which occurred during August 1995, one Class A common share, 0.5 of a Series 1 share purchase warrant, and 0.5 of a Series 2 share purchase warrant. Each full series 1 warrant entitled the holder to acquire, subject to adjustments, one Class A common share at a price of Cdn $1.90 until February 21, 1997, while each full Series 2 warrant entitled the holder to acquire, subject to adjustments, one Class A common share at a price of Cdn $2.25 until February 23, 1998. In connection with the private placement, the Corporation granted to its Underwriter compensation warrants entitling it to acquire until February 21, 1997, up to 133,333 Class A common shares at a price of Cdn $1.50 per share and up to 133,333 Class A common shares at a price of Cdn $1.90 per share. All of the Series 1 warrants and compensation warrants were exercised before the expiry date. The Series 2 warrants were exercised as to 200,333 warrants for the period ended December 31, 1997 and as to 1,193,000 for the year ended December 31, 1998.

d) During March 1996, the Corporation completed a Cdn $5.6 million (U.S. $4.1 million) private placement of 2,550,000 special warrants at Cdn $2.20 each, realizing approximately Cdn $5.1 million (U.S. $3.8 million), after the Underwriter's commissions and other expenses related to the issue. Each special warrant entitled the holder to receive upon exercise, which occurred during May, 1996, one Class A common share and 0.5 of a series 3 share purchase warrant. Each full series 3 warrant entitled the holder to acquire, subject to adjustments, one Class A common share at a price of Cdn $2.50 until February 21, 1997. In connection with the private placement, the Corporation granted to its Underwriter compensation warrants entitling it to acquire until March 21, 1997, up to 150,000 Class A common shares at a price of Cdn $2.30 per share. All 1,275,000 Series 3 warrants and all 150,000 compensation warrants were exercised prior to the expiry date.

e) On September 5, 1996, the Corporation completed a Cdn. $55 million (U.S. $40.1 million) private placement of Class A Special Warrants. A total of 12,223,000 Class A Special Warrants, exchangeable into an equal number of Class A common shares of the Corporation, were issued at Cdn $4.50 per Class A Special Warrant. The Corporation failed to clear a final prospectus within the prescribed time period required by the Class A Special Warrant indenture, to qualify shares for exchange and as a consequence, each Class A Special Warrant entitled the holder to receive on exercise of the Class A Special Warrant an additional warrant (a "Series 4 Warrant"). In accordance with the terms of the special warrant indenture governing the Class A Special Warrants, the Class A Special Warrants were deemed to have converted into 12,223,000 common shares and 12,223,000 Series 4 Warrants. Five Series 4 Warrants, plus Cdn $5.10 entitled the holder to purchase one additional Class A common share of Hurricane. During the year ended June 30, 1997, 2,384,457 Class A common shares were issued on exercise of 11,922,285 Series 4 Warrants for gross proceeds of $8,798,646. The remaining 300,715 Series 4 Warrants expired.

f) On November 26, 1996, the Corporation issued by private placement a total of 10,476,000 Class B Special Warrants, exchangeable into an equal number of Class A common shares, for Cdn $55 million (U.S.$41.0 million). Under the terms of the issue, the Corporation did not qualify shares to be exchanged for the Class B Special Warrants within the prescribed time frame and as a consequence each Class B Special Warrant entitled the holder to receive an additional 0.072 Class A common shares. In accordance with the terms of the special warrant indenture governing the Class B Special Warrants, the Class B Special Warrants were deemed to have converted into 11,230,272 Class A common shares.

g) On March 26, 1997, the Corporation issued 110,000 Special Warrants (see Note 7). Each Special Warrant was exercisable, partially into 45 Series 5 Warrants. As described in Note 7, Cdn $2,475,000 (U.S.$1,801,048) of the proceeds were allocated to the Series 5 Warrants. Each Series 5 Warrant entitles the holder to purchase one common share of the Corporation at a price of Cdn $6.25 until March 26, 2002. If after March 26, 2000, the current market price of the common shares of the Corporation is greater than Cdn $12.50, the Corporation has the right to accelerate the expiry date to 20 days after the date the Corporation gives the required notice to the holders of Series 5 Warrants. The Special Warrants were deemed to be exercised 5 days after a receipt was issued for the prospectus which was dated July 21, 1997; accordingly, 4,950,000 Series 5 Warrants were issued. All 4,950,000 Series 5 warrants are currently outstanding at December 31, 1998 and 4,950,000 shares have been reserved for issuance upon the potential exercise of these warrants.

h) The following stock options were outstanding at December 31, 1998:

Date of Grant	Number Outstanding	Exercise Price Cdn$	Expiry Date
May 2, 1995	40,000	2.00	May 1, 1999
July 13, 1995	50,000	2.00	July 12, 1999
December 27, 1995	10,000	1.75	December 26, 1999
February 3, 1996	100,000	1.90	February 2, 2000
March 13, 1996	35,000	2.15	March 12, 2000
August 20, 1996	40,000	4.50	August 19, 2000
September 17, 1996	40,000	5.10	September 17, 2000
November 5, 1996	47,500	4.04	November 4, 2000
November 13, 1996	44,000	4.04	November 12, 2001
November 13, 1996	535,000	5.70	November 12, 2001
December 3, 1996	30,000	4.04	December 2, 2001
January 14, 1997	15,000	4.04	January 13, 2002
March 12, 1997	50,000	6.10	March 11, 2002
March 12, 1997	100,000	4.04	March 11, 2002
June 16, 1997	90,000	4.04	June 15, 2002
July 22, 1997	50,000	6.60	July 21, 2002
August 27, 1997	75,000	4.04	August 26, 2002
August 27, 1997	1,340,000	9.30	August 26, 2002
October 6, 1997	5,000	4.04	October 5, 2002
March 27, 1998	40,000	4.04	March 26, 2002
April 14, 1998	125,000	9.65	April 13, 2003
August 4, 1998	30,000	4.04	August 3, 2003
	2,891,500		

The above table reflects 499,000 stock options which were re-priced to an exercise price of $4.04 Cdn. per share on October 21, 1998.

i) During the year, the Corporation, under its Normal Course Issuer Bid, purchased for cancellation 190,900 Class A common shares for an aggregate consideration of $389,800. The excess of the purchase price over the stated value of $190,530 was charged to retained earnings.

9. INCOME TAXES AND GOVERNMENT CHARGES

The Corporation and its subsidiaries are required to file tax returns in each of the jurisdictions in which they operate. The prime operating jurisdictions are Canada and Kazakhstan.

The provision for income taxes differs from the results which would have been obtained by applying the combined Canadian Federal and Provincial income tax rate to Hurricane's income before income taxes. This difference results from the following items:

	Year Ended December 31 1998	Six Months Ended December 31 1997	Year Ended June 30 1997
Effective combined Canadian federal and Provincial income tax rate	44.6%	44.6%	44.6%
Expected tax expense	$ (102,252,683)	$ 10,219,312	$10,025,097
Non-deductible amounts, net	3,137,538	2,165,800	1,746,589
Lower foreign tax rates	(1,079,845)	(4,335,227)	(3,785,178)
Deferred income tax benefit not recognized	103,751,990	3,152,082	1,945,276
Deferred income tax benefit recognized	(360,000)	(4,132,500)	—
Other taxes and government charges	19,447,404	—	37,941
Income tax expense	$ 22,644,404	$ 7,069,467	$ 9,969,725

The Corporation's principal subsidiary, HKM, and the Corporation's other subsidiaries and joint ventures operating in Kazakhstan are separate taxpayers under Kazakhstani tax legislation.

Taxes are payable in Kazakhstan based on financial statements prepared in accordance with the laws of Kazakhstan rather than financial statements prepared in accordance with generally accepted accounting principles ("GAAP") in Canada. The majority of the differences between the two sets of financial statements are timing differences where an expense or revenue item is recorded for Canadian GAAP purposes earlier than allowed under Kazakhstani law. The provision for Kazakhstani income taxes has been calculated by applying the Kazakhstani statutory tax rate of 30% to the income of Hurricane's Kazakhstan subsidiaries. For 1998, other subsidiaries have tax deductions available in excess of accounting deductions, the benefits of which have not been recognized.

Other taxes and government charges consists of amounts paid or accrued as payable for assessments, fines, penalties and interest related to prior year's filings of $19,447,404. This amount includes amounts which is some cases have been actively appealed by the Corporation. If the Corporation is successful in its appeals, the consequent reductions will likely be applied against future liabilities. In light of the uncertainty in the timing of these recoveries, the Corporation has chosen to provide for these items at this time.

10. SEGMENTED INFORMATION

The Corporation's oil and natural gas exploration, development and production activities are conducted in both Canada and the Republic of Kazakhstan. The following information relates to the Corporation's operations by country:

	Year Ended December 31 1998	Six Months Ended December 31 1997	Year Ended June 30 1997
REVENUE			
Canada	$ 230,535	$ 156,627	$ 190,927
Kazakhstan	173,849,025	93,771,744	84,477,595
Corporate	1,869,584	875,807	505,754
Total	$ 175,949,144	$ 94,804,178	$ 85,174,276
SEGMENT OPERATING PROFIT (LOSS)			
Canada	$ (97,787)	$ (34,041)	$ (776,559)
Kazakhstan	(6,277,201)	33,059,313	27,482,535
Total	(6,374,988)	33,025,272	26,705,976
Administration and other expense	(3,827,100)	(4,053,390)	(2,153,716)
Interest and financing costs on long-term debt	(28,408,784)	(6,027,033)	(2,139,603)
Foreign exchange gain (loss)	5,426,123	(31,594)	65,139
Ceiling test write-down	(173,436,952)	—	—
Income taxes and government charges	(22,644,404)	(7,069,467)	(9,969,725)
NET INCOME (LOSS)	$(229,266,105)	$ 15,843,788	$ 12,508,071
TOTAL ASSETS			
Canada	$ 1,452,366	$ 1,492,280	$ 1,127,344
Kazakhstan	127,704,033	250,916,740	232,620,368
Corporate	531,044	102,888,881	21,814,945
Total	$ 129,687,443	$ 355,297,901	$ 255,562,657

11. COMMITMENTS AND CONTINGENCIES

Kazakhstani Environment

In recent years, Kazakhstan has undergone substantial political and economic change. As an emerging market, Kazakhstan's business infrastructure is not as advanced as those generally existing in more developed free market economies. As a result, operations carried out in Kazakhstan can involve risks that are not typically associated with those in developed markets. The development of instability in the on-going market transformation process could lead to changes in the fundamental business infrastructure in which the Corporation currently operates. Changes in the political, legal, tax or regulatory environment could adversely impact the Corporation's operations.

Government Taxes and Legislation

Kazakhstan currently has a number of laws related to various taxes imposed by both federal and regional taxation authorities. Applicable taxes include value added tax, corporate income tax, a number of revenue based taxes, and payroll taxes. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, rules, accepted and administrative practices and regulations are often difficult to interpret, ambiguous or nonexistent. Accordingly, few precedents with regard to issues have been established. Often, differing opinions regarding legal interpretation exist both among and within government ministries, thus creating uncertainties and areas of conflict. Tax declarations, together with other legal compliance matters, are subject to review and investigation by a number of authorities who are enabled by law to impose significant fines, penalties and interest charges. These issues create tax risks in Kazakhstan substantially greater than risks typically arising in countries with more developed tax systems.

Generally, tax declarations remain open and subject to inspection for a period of five years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review during the five year period. Substantially all taxes were reviewed by the tax authorities through 1998.

Management believes that it has adequately provided for tax liabilities in the accompanying financial statements; however, significant risk remains that authorities could take differing positions with regard to interpretive issues and the impact on the Corporation's financial position could be significant.

At December 31, 1998, the Corporation has accounts receivable of approximately $4,622,000 and long-term accounts receivable of $3,078,000, in respect of amounts the Corporation believes are due from relevant tax authorities in Kazakhstan and which are in dispute. The relevant taxation authorities have acknowledged the Corporation's claims with respect to these amounts, but have not agreed with the Corporation's position, made cash settlements or allowed the application of cash taxes otherwise payable against these disputed amounts. The Corporation believes that it will receive cash settlement of such balances in current and future periods or will be able to reduce cash taxes otherwise payable against such amounts when successfully resolved in the Corporation's favour.

In addition, relevant tax authorities have claimed the Corporation owes approximately $6,100,000 relating to a particular unresolved tax matter. The Corporation does not believe that this claim is valid and accordingly has not recorded any amount in respect of this claim.

Production Licenses

The Corporation has a 50% interest in the Kumkol North field through a joint venture with OJSC Oil Company LUKoil, a Russian oil company ("LUKoil"). The joint venture, Kumkol-LUKoil CJSC ("Kumkol-LUKoil"), is the operator of the Kumkol North field. Kumkol-LUKoil, under the exploration and production license dated December 20, 1995 (the "Kumkol North License") for the Kumkol North producing oil field, has committed to invest 5.3 billion tenge, 5.4 billion tenge, 2.6 billion tenge and 2.5 billion tenge in 1996, 1997, 1998 and 1999, respectively, which, at the exchange rate in effect at December 31, 1995, would be approximately $82.0 million, $84.8 million, $41.1 million and $38.8 million, respectively, and at the exchange rate in effect at December 31, 1998 would be approximately $63.2 million, $64.4 million, $31.0 million and $29.8 million, respectively.

Kumkol-LUKoil did not satisfy this commitment in 1996, 1997 or 1998. The Corporation intends to seek to renegotiate the terms of the Kumkol North License, including obtaining a waiver of any breaches of its capital investment commitments under such license. Any such renegotiation would require the approval of LUKoil. There can be no assurance that either LUKoil or the Government of Kazakhstan will agree to renegotiate the Kumkol North License or that the Government of Kazakhstan will waive the breach of the Company's capital investment commitments under such license. The failure to satisfy the capital investment commitments with respect to the Kumkol North producing oil field may result in the cancellation of the Kumkol North License. To date, the Corporation has received no notice from the Government of Kazakhstan of its intent to terminate the Kumkol North License. The Kumkol North producing oil field represents approximately 29% of the Corporation's net proved reserves. Under the Share Sale-Purchase Agreement, HKM has the right to have the license for the Kumkol North producing oil field reissued to HKM in the event of the cancellation of the existing Kumkol North License.

Capital Expenditures Commitment

Pursuant to the Share Sale-Purchase Agreement with the Republic of Kazakhstan (note 3), a commitment was made to invest, in Kazakhstan, an aggregate of $280 million U.S. in capital expenditures, investments or other items which may be treated as capital assets of HKM on or before December 31, 2002. These expenditures will be used to further exploit and develop existing fields and to explore for new additional reserves to enhance future production and revenues. If the required investment is not made within the agreed time period, Hurricane will be required to pay a penalty of 15% of the amount not invested. Expenditures relating to the construction of the road to Kyzl-Orda and the gas processing plant, as described below, may be applied against the commitment. As at December 31, 1998, approximately $174.3 million (December 31, 1997 - $59.9 million; June 30, 1997 - $27.8 million) of expenditures have been made towards satisfying this commitment.

The State Privatization Committee (the "Privatization Committee") is the relevant government authority responsible for administering the Corporation's compliance with the capital expenditures commitment and, on an annual basis, the Corporation submits a report of its capital expenditures. The Privatization Committee has performed an audit of the expenditures made in calendar 1997 and has not invalidated any expenditures in the report filed with the Privatization Committee. However, there is no certainty that the Privatization Committee will continue to concur with the nature and quantity of the expenditures the Corporation has filed or will file in the future in reports to the Privatization Committee.

Road Construction

HKM is constructing a road from Kyzl-Orda to the Kumkol Field for the purpose of accelerating development of the Kumkol Field. To December 31, 1998, $40.3 million (December 31, 1997 - $20.6 million; June 30, 1997 - $18.2 million) has been expended. Further expenditures to complete the road are estimated by HKM management to be approximately $12.4 million (December 31, 1997 - $32.1 million, June 30, 1997 - $34.5 million). The Share Sale Purchase Agreement obligates the Ministry of Oil and Gas Industry of Kazakhstan to ensure that all entities participating in the development of the South Turgai fields (fields adjacent to the Kumkol Field), bear their proportionate share in the construction costs. The amount to be recovered through their participation is presently not determinable and no amount has been recorded for this recovery.

Environmental Matters

Gas and gas liquids produced in the Kumkol Field are currently being flared. HKM has undertaken to conduct a feasibility study regarding the extraction of the gas and gas liquids and the construction of a facility which would use the gas to produce electricity.

Relationship with Refinery

On December 3, 1998 the Committee of the Republic of Kazakhstan for the Regulation of Natural Monopolies and the Protection of Competition (the " Competition Committee") issued a Warrant (the "Warrant") to OAO Shymkentnefteorgsyntez ("ShNOS") providing for the immediate cessation of alleged violations of anti-monopoly legislation. The Committee alleged that ShNOS, in violation of the law of the Republic of Kazakhstan concerning unfair competition, had used their position as a monopolist to reduce the number of crude oil suppliers to ShNOS from fifteen to one. The Warrant also alleged that in contradiction to the law of the Republic of Kazakhstan concerning the development of competition and limitation of monopolistic activity, ShNOS had taken actions to ensure that they became an enterprise with a dominant market position. The Corporation maintains that the activities of ShNOS adversely impacted current year earnings and operating results.

The Corporation delivers all of its production by pipeline to the ShNOS refinery in Southern Kazakhstan. The Corporation may sell crude to ShNOS or pay ShNOS a fee to refine the crude and sell the refined products in competition with ShNOS and others. The processing fee has been set at $20 per metric tonne in a contract which expires in September 1999.

The Corporation is currently in merger negotiations with ShNOS (note 13). The outcome of the Warrant and its impact on the Corporation are not determinable at this time.

Employee Salaries and Wages

The Corporation has not paid certain employees' regular salaries and wages in full since October, 1998. The Corporation has accrued the outstanding salaries and wages payable to December 31, 1998 and is committed to paying these wages and salaries in full.

12. INCOME (LOSS) PER SHARE

The income per share calculations are based on the weighted average number of Class A common shares outstanding during the period. Exercise of outstanding purchase warrants and stock options would result in a fully diluted loss per share for the year ended December 31, 1998 of $5.18 (income per share for six-months ended December 31, 1997 - $0.33; year ended June 30, 1997 - $0.37).

13. COMMITMENTS AND CONTINGENCIES ARISING SUBSEQUENT TO YEAR END

Companies' Creditors Arrangement Act

On May 14, 1999, the corporation, as a result of financial difficulties, applied for and obtained an order from the Court of Queen's Bench of Alberta (the "Court") under the CCAA.

The initial order received from the court provided protection to the Corporation from the legal actions of creditors until June 11, 1999 while the Corporation prepares a plan to arrange its financial affairs. The Court has granted an extension in the CCAA protection to September 30, 1999, provided that the Corporation files a plan to arrange its financial affairs by July 22, 1999.

While the Corporation believes the Court will continue to extend the period of protection to allow for satisfactory arrangement of the Corporations' financial affairs, there can be no certainty that the Court will continue to provide protection under CCAA for a time period sufficient for the Corporation to satisfactorily arrange its financial affairs. At this time, it is not determinable what the outcome of this matter will be, nor can it be determined what the impact may be on the Corporation's operations.

Default on Long-Term Debt

The Corporation has not paid interest amounts due under the terms of both the U.S. and Canadian Notes. Interest payments of $6,168,750 and $4,078,193 were due on May 1, 1999 and June 1, 1999 on the U.S. and Canadian Notes respectively. This non-payment of interest constitutes an act of default under the terms of the U.S. and Canadian Notes. The Corporation is presently pursuing resolution of the default. However, there can be no certainty that the holders of the Notes will not exercise their rights and privileges available under the terms of both Notes.

At this time, it is not determinable what the outcome of this matter will be, nor can it be determined what the impact may be on the Corporation's operations.

Proposed Acquisition of OAO Shymkentnefteorgsyntez

On April 23, 1999, the Corporation signed a letter of intent with OAO Shymkentnefteorgsyntez ("ShNOS") in which both parties have agreed to negotiate the acquisition of ShNOS by the Corporation.

The material terms of this proposed acquisition are as follows:

- Hurricane will be reorganized under a "plan of arrangement" which is to include a conversion of all or an agreed lesser amount of the long-term debt to equity, and a satisfaction of all trade creditors and wage creditors and a new cash equity investment is to be made if required.

- ShNOS shall not have any long-term debt.

- Hurricane is to acquire all of the shares of ShNOS for common shares of Hurricane. The ratio of shares to be held by the shareholders of each entity has been determined subject to specific conditions being met by each party to the agreement.

- ShNOS will pay $7 million to Hurricane as a prepayment for crude oil or refined products. The amount is required to be repaid through retention by ShNOS of 25% of amounts payable to Hurricane (not to exceed $1,750,000 per 30 day period) under the terms of the Joint-Marketing Agreement signed concurrently with the letter of intent. The advance bears no interest and is due in the current period.

- The transaction is subject to completion of due diligence investigations to be completed by both parties.

- The parties agreed to proceed to develop a plan of arrangement and a definitive agreement.

Joint Marketing Agreement and Advance of Funds from OAO Shymkentnefteorgsyntez

On April 23, 1999, in conjunction with the signing of the letter of intent with ShNOS, the Corporation also entered into a joint marketing agreement with ShNOS to govern supply of crude oil to the refinery, the processing by the refinery and the joint marketing of refined products.

Lawsuits

The Corporation has been named as defendant in lawsuits filed by former suppliers to the Corporation in Kazakhstan and Canada with respect to certain amounts that have not been paid within contractual credit terms. The Corporation remains committed to paying such amounts.

In addition, the Corporation has been named as defendant in a lawsuit filed by a former executive of the Corporation claiming, in aggregate, $2.3 million. The Corporation believes that this lawsuit is without merit and, accordingly, no amount has been recorded in the consolidated financial statements for the year ended December 31, 1998.

Currency Devaluation

On April 4, 1999, the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan announced their joint decision to introduce a free-floating exchange rate for Kazakhstan's currency, the tenge. In taking the decision to allow the tenge to adjust for market rates, the Chairman of the National Bank alluded to the pressure put on the tenge by continuing devaluation of the Russian Federation's currency, the rouble. The devaluation of the rouble, along with other factors, had made certain Russian oil products more competitive than those of the Corporation. The full impact of the continuing deterioration of the Russian economy and the change in current Government policy regarding the tenge on the Corporation's operations can not be determined at this time.

14. SUBSEQUENT EVENTS

Marketing Agreements

On April 9, 1999, the Corporation signed a crude oil purchase/sale agreement for exporting 15,000 to 40,000 metric tons per month, for a price based on Brent prices less a differential to be negotiated monthly, initially set at $9.85 per barrel. The agreement is for a one year term and may be cancelled by seller or buyer on 60 days notice.

The Corporation has, on May 9, 1999, signed a long-term agreement which sets out the framework for exports to China. The volumes and prices are to be agreed upon on a month by month basis.

Advance Under Joint Marketing Agreement

Pursuant to the terms of the joint marketing agreement, ShNOS provided the Corporation with a $7,000,000 short term credit advance against future delivery of crude oil. The advance bears no interest and is due in the current period.

15. COMPARATIVE FIGURES

The presentation of certain accounts for previous periods has been changed to conform with the presentation adopted for the current year.

16. YEAR 2000 ISSUE

The Year 2000 Issue arises because many computerized systems use two digits rather than four to identify a year. Date sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems may arise in some systems which use certain dates in 1999 to represent something other than a date.

It is uncertain as to whether the Kazakhstani government and other Kazakhstani organizations providing significant infrastructure services have sufficiently addressed the Year 2000 Issue to mitigate disruption of service or an adverse affect on the operations of the Corporation. Furthermore, the current economic situation in Kazakhstan could also adversely affect the ability of these and other organizations to fund Year 2000 compliance programmes.

The effects of the Year 2000 Issue may be experienced before, on, or after January 1, 2000, and, if not addressed, the impact on operations and financial reporting may range from minor errors to significant systems failure, which could affect an entity's ability to conduct normal business operations. It is not possible to be certain that all aspects of the Year 2000 Issue affecting the Corporation, including those related to the efforts of customers, suppliers, or other third parties, will be fully resolved.

These financial statements do no include any adjustments that might be necessary as a result of this uncertainty.

FUTURE ORIENTED FINANCIAL INFORMATION

	1998 Reforecast	1998 Actual	Variance
Sales (BOE)	19,875,462	19,196,913	(678,549)
Sales (BOPD)	54,453	52,594	(1,859)
(US $,000's)			
Revenue			
Oil Sales	$ 190,322	$ 171,752	$ (18,570)
Interest, etc.	3,245	4,197	952
	193,567	175,949	(17,618)
Expenses			
Production	78,129	75,492	(2,637)
Provision	11,000	12,500	1,500
Royalties	14,175	12,177	(1,998)
General & administrative	43,898	41,071	(2,827)
Interest and deferred financing costs on long-term debt	22,016	30,541	7,525
Depletion and depreciation	42,985	42,779	(206)
Ceiling test write-down	-	173,437	173,437
Foreign exchange gain	(4,308)	(5,426)	(1,118)
	207,895	382,571	174,676
Income before tax	(14,328)	(206,622)	(192,294)
Taxes and other government charges	6,294	22,644	(16,350)
Net income	$ (20,622)	$ (229,266)	$ (208,644)
Cash Flow from Operations	$ 23,357	$ (11,891)	$ (35,248)
EBITDA	$ 45,082	$ 28,961	$ (16,121)

In its report for the nine months ended September 30,1998, the Company issued a reforecast of its results for 1998. Actual sales volume for the year was 678,549 barrels lower than forecast. Combined with lower than expected prices, this resulted in revenues being $17.6 million lower than the reforecast. For the most part, costs were also lower than the reforecast, with the notable exceptions being the ceiling test write-down, interest charges related to the reclassification of the long-term debt and the additional provisions for taxes and other government charges which negatively impacted fourth quarter results. The combined effect of these factors was to produce a cash flow deficit for the year of $11.8 million compared with the reforecast cash flow of $23.4 million and earnings before interest, taxes, depreciation and amortisation of $28.9 million compared with $45.1 million in the reforecast.

CORPORATE INFORMATION

TRANSFER AGENTS

Montreal Trust Company of Canada
Calgary, Alberta
Toronto, Ontario

TRUSTEES

Montreal Trust Company of Canada
Calgary, Alberta – Cdn. Note Issue

Marine Midland Bank
New York, New York – U.S. Note Issue

SHARE LISTINGS

Alberta Stock Exchange (HHL.A)
The Toronto Stock Exchange (HHL.A)
Nasdaq (HHLFQ)
Berlin (HHLa.BE)
Frankfurt (HHLa.F)

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